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Memorandum

FOREIGN AID PROBLEMS IN SOUTH ASIA

21 June 1965

State Department review completed

DIRECTORATE OF INTELLIGENCE

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No. 1816/65

21 June 1965

CENTRAL INTELLIGENCE AGENCY
MEMORANDUM

Foreign Aid Problems in South Asia

Summary

Inadequately aware of the increased opposition in the West to foreign aid, India is drawing up its Fourth Five-Year Plan which will require about \$7.5 billion in the plan period as compared to the \$5 billion received during the previous five year period. India is already the single largest recipient of American and Soviet bloc assistance. Yet its economic ills are continuing and serious. While the foreign aid requirements of Pakistan and Ceylon are much smaller, the requirements of South Asia for external assistance are likely to be massive.

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FOREIGN AID PROBLEMS IN SOUTH ASIA

India

1. India's foreign aid needs are becoming astronomical. It is already the single largest recipient of American and Soviet bloc assistance in the world. It receives--from the US--\$450 million a year in economic aid, and in the period July 1964 - June 1965, PL-480 wheat shipments reached about \$400 million or about seven million tons, some 15-20 percent of the annual US wheat crop.* Given India's annual population growth of about eleven million a year, and continuing domestic difficulties in increasing food production, the present level of PL-480 shipments will probably have to be maintained or even increased somewhat for several years if further food crises are to be avoided. Indeed, our embassy in New Delhi has recommended that these shipments be increased by one million tons for each of the next two years.

2. Two factors make an Indian request for a major aid increase likely. Most of the assistance supplied by Western countries, recently amounting to over a billion dollars a year, has been in the form of loans, and the schedule of debt and interest repayments is rising rapidly. During India's scheduled Fourth Five-Year Plan (to begin in April 1966) total foreign debt servicing will rise to about \$2.5 billion, or an average of \$500 million dollars annually. Many Indian planners apparently believe that increased foreign aid would in itself accelerate India's three-four percent rate of growth to something like the five-six percent achieved

* India has also received pledges of substantial US military assistance, both as loans and grants, of some \$100 million a year. This military aid is not considered here.

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by Pakistan, which has gotten more than double the per capita aid received by India.*

3. India's actual aid request to the West (which will be made later in 1965) will probably be based on a balance between what New Delhi thinks it will need and what it thinks it can get. Some of its leaders recognize the difficulty of getting more external assistance; however, they have already prepared the outline of a plan which calls for a substantial increase in external assistance. If the Shastri government retains the goals of the Fourth Plan as presently conceived, it is likely to ask the Aid-to-India Consortium for a combination of debt postponements and increased financial assistance amounting to about \$1.5 billion a year or \$7.5 billion during the plan period. However, there is likely to be increasing Western pressure in the next few months to revise the still tentative Fourth Plan downward to more realistic levels. Indeed, in April 1965, India requested \$1.2 billion from the consortium but received only \$1 billion. Given the strength of this pressure, combined with rising donor resistance to higher aid levels, Delhi will in time probably agree to some eventual

* In April 1965 the US Embassy in New Delhi stated that India's requirements for foreign assistance--aside from PL-480 shipments--will be about \$9.5 billion dollars in the Fourth Plan. The Embassy believes that about \$2 billion can be obtained from private investors and sources other than the Consortium (primarily the USSR). This would leave needs of nearly \$7.5 billion, or \$1.5 billion a year--of which the US would pay at least half. Furthermore, debt servicing charges probably will be larger than the \$2.1 billion cited by the Embassy. The Embassy probably also overstates India's ability to attract private investment in the near future. At present, there is a small net outflow of private exchange resources. While the situation will probably improve, India is unlikely to receive more than a hundred million a year in net private foreign investment.

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reductions in the Fourth Plan and thus in its foreign aid requirements, but will attempt to keep such cuts to a minimum.

4. Soviet bloc aid, which India is now utilizing at the rate of about \$200 million a year, will probably increase. During Shastri's Moscow visit in May 1965, the USSR agreed to provide India with substantial economic aid during the Fourth Plan period. This, together with increased aid already available from Eastern Europe, should permit New Delhi to draw about \$250-300 million annually from these sources. Most West European countries are showing considerable reluctance to enlarge their Indian aid programs--an attitude we think will continue. This would leave only the US, which may be asked to pay up to double its present \$450 million a year Aid-to-India program. Many Indian leaders appear unaware that such a jump would be viewed with little enthusiasm by the American Congress, which has just authorized an aid program for FY 1966 of \$2.3 billion in economic assistance for the entire underdeveloped world.

5. India's unsatisfactory growth rate of the last few years has not resulted exclusively from too little external assistance, though shortages of imported materials have played a part. However, India's planned economic growth has been retarded by a variety of factors: heavy military expenditures, planning failures, over-emphasis on industrialization, the government's inefficient public sector projects, its penalizing of the more vigorous and creative private sector, its excessive regulation of economic life, and its discouragement of private foreign investment. India has overemphasized projects with long gestation periods to the detriment of agriculture and agricultural-oriented industries. Foreign exchange is now being spent on food grains and fertilizers that could have been used for maintenance of the economy-type imports. As a result many domestic industries are operating below capacity. Because of domestic inflation and India's sheltered market the development of the export sector has been neglected and industrial output

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has been oriented to the home market, thus further aggravating the exchange shortage.

6. If New Delhi were simply provided with requested increases in foreign aid, it would persist in following the same policies that have led to the present difficulties. However, the offer of more aid--on condition that reforms be made in Indian economic practices--would probably bring about some economic liberalization and the release of those repressed energies of the private sector so long desired by Western economists. There would be considerable resistance in India to such changes and progress on these lines would not be fast.

7. Given increased aid--particularly non-project aid--and suitable economic reforms, India's rate of economic growth would probably rise above four percent a year, but in the absence of a dramatic breakthrough in agriculture and a more rapid expansion of exports the growth rate would not approach the six-seven percent the planners are aiming at. If foreign aid to India continues at about present levels, and no significant debt postponements are granted, India's planners will probably be forced to cut back their goals. In this situation, we believe that India's rate of growth probably would decline somewhat. Public dissatisfaction would increase, and over the long term the Shastri government would be weakened. However, its tenure, and control of the Indian political scene, would probably not be threatened for some time.

Pakistan

8. Though still an extremely poor country, Pakistan has experienced an impressive growth rate in the last five years--about five percent annually. This has been made possible both by Karachi's sound economic policies (particularly its reliance on private initiative), and by a relatively high level of foreign aid. During its Second Five-Year Plan, which ends in July 1965, Pakistan received nearly \$2.2 billion dollars in external assistance, exclusive of PL-480. Of this, \$1.3 billion dollars (about \$260 million a year) came from the US, which has also given very substantial military aid as well (over \$700 million worth in the period 1954-1964).

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9. The Pakistanis hope to improve their performance even further in the Third Five-Year Plan (July 1965 - June 1970) and are aiming for a growth rate of 6.5 percent per year. To achieve these goals, Karachi's planners calculate that they will need about \$3 billion dollars in foreign aid in this five-year period. Most will come from the Aid-to-Pakistan Consortium.* The US will probably be expected to provide about half of this \$600-million annual assistance. Further, the plan is counting on a minimum of \$840 million in PL-480 deliveries in this five-year period--a figure which will have to be revised upward if, as is likely, agricultural production fails to expand as rapidly as planned.

10. Pakistan's economic performance has impressed most Free World countries, and if the US continues large-scale aid these countries will probably do the same. (The Communist countries may provide some aid, but are likely to fill only a minor part of Pakistan's needs).** The Consortium will probably be unwilling greatly to increase its aid, however, so it seems unlikely that Pakistan will receive somewhat less aid than it desires. Even so, given a modest increase over present aid levels, and the continuation of sound economic policies, the economy will probably grow by about five percent annually--still an impressive rate. In any case, Pakistan, like its neighbor India, will remain heavily dependent on foreign aid for many years to come. The sudden loss of such assistance would probably mean a sharp reduction in national output and the prospects for economic development, and would, over a period of time, seriously weaken the nation's political and social stability.

*Consortium members include the US, the International Bank for Reconstruction and Development, West Germany, the UK, Japan, and Canada.

**In late 1964, Communist China granted Pakistan a credit of \$60 million, of which little is likely to be utilized for some time.

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Ceylon

11. Ceylon's economic problems have become more serious in recent years, though the country remains relatively well off by Asian standards. While these are, in theory, remediable, political considerations will make their solution difficult. Ceylon's government has limited ability to impose needed, but unpopular, measures on the general public, and its foreign exchange needs are greater than those of Afghanistan. The newly elected, relatively pro-Western, Senanayake regime has inherited a situation wherein its leftist predecessor subordinated long-term development programs. Rather, it used the income from its extensive export earnings and its foreign exchange reserves to pay for increasingly expensive social welfare and food subsidy schemes. These reserves are now almost exhausted; Ceylon now suffers from worsening terms of trade, increasing inflation, consumer goods shortages, and unemployment. In the short term, Colombo could either drastically cut back on its subsidy and welfare measures--an act of political suicide--or get emergency external assistance as a substitute for its depleted reserves.

12. An IMF representative has tentatively estimated Ceylon's immediate needs at a total of \$50-70 million for the next year in order to maintain price stability and economic activity. The IMF, which is sending a team of experts to make a definitive survey, is prepared to advance up to \$30 million during the next year, and hopes that Western public and private sources will contribute the remainder. The Ceylon Government, not surprisingly, puts its needs much higher--at some \$72-94 million in commodity and foreign exchange assistance--for extraordinary food purchases (made necessary by natural disasters) and for replenishing those shortages, e.g., in fertilizer, chemicals, transport equipment, and electrical goods which now hamper domestic productive capacity. If Ceylon is to receive this aid, the US would have to provide much of it, though the UK has agreed to provide a considerable amount. The US has been restricted by law from giving any aid in recent years, since Ceylon had not made a satisfactory settlement with those US oil companies whose properties it had nationalized. A mutually satisfactory agreement

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appears to have been reached, though not finally confirmed, and this obstacle has probably been removed.

13. The IMF, US, and the UK insist that large-scale assistance must be accompanied by major internal reforms: that is, Ceylon's government must, over a period of time, reduce or eliminate its expensive food subsidy schemes. These freed resources should then be diverted to long-term development programs. However wise such moves might be from an economic standpoint, they will be politically very difficult. Ceylonese public opinion strongly favors retention of present subsidies--no matter what the US Government and taxpayer think, and Senanayake's power rests on a small and potentially unstable parliamentary majority, which will be reluctant to accept drastic austerity measures. It appears that the government will attempt a compromise between the advice of potential aid donors and the desires of the Ceylonese public, gradually instituting economic reforms while receiving economic aid. Under these conditions, Ceylon stands a good chance of receiving sufficient assistance to deal with its economic problems for the next six months or a year. However, barring a sharp rise in commodity prices, we do not expect a dramatic improvement in Ceylon's economic status.

Conclusion

14. Ceylon, India, and Pakistan will probably devote considerable energies to acquiring foreign aid in coming years to help overcome their economic problems. Producers and exporters of raw materials, they are vulnerable to shifts in terms of trade. They have little in the way of foreign exchange reserves to fall back on, and there is little prospect for improvement in the next few years. Their industrialization programs have not made them economically independent. Their industries now require large amounts of exchange to purchase spare parts and raw materials to keep them functioning. Even when operating at full capacity, these industries will not generally be competitive in Western markets. Prospects for improved export earnings remain poor, and dependence on external resources will continue, and probably increase. However, Western resistance to such aid is increasing, and most South Asian leaders have so far shown only partial awareness of this fact.

ECONOMIC ASSISTANCE TO CEYLON

(US \$ Millions)					
	1961	1962	1963	1964	1950-64
Communist Countries <u>a/</u>					
USSR	0	0	0	0	30.0
Other	0	10.5	8.0	4.2	51.1
Total	0	10.5	8.0	4.2	81.1
Free World <u>b/</u>					
U.S.					
Food for Peace (PL 480)	9.5	4.2	7.8	3.3	64.9
Other Economic	0.1	1.4	-2.8	0	22.5
Total U.S.	9.6	5.6	5.0	3.3	87.4
UK	N.A.	N.A.	N.A.	N.A.	7.8
Other	N.A.	N.A.	N.A.	N.A.	129.4
Total					294.6

a/ Calendar year. Between January and June 1965, East Germany extended a \$42.0 million credit and the USSR extended a \$0.6 million grant.

b/ Fiscal Year.

See Attached written comments.

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Ceylon has utilized only \$26.4 million of the \$81.8 million in economic aid extended by Communist countries between 1956-64. Practically all US aid has been utilized since most US assistance was in the form of surplus agricultural commodities. Aid from other free world countries has been almost entirely allocated for specific projects, and most of this aid has apparently been drawn.

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Table 1
Economic Assistance Pledged to India

	(\$ Million)				
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>Cumulative Total 1948-65</u>
Soviet Bloc <u>a/</u>					
USSR	125	0	0	211.0	1,022.1
Other	<u>15.9</u>	<u>32.5</u>	<u>0</u>	<u>84.0</u>	<u>255.2</u>
Total Soviet Bloc	140.9	32.5	0	295.0	1,277.3
Free World <u>b/</u>					
US					
Food for Peace (PL 480)	275.2	276.1	294.4	398.0	2,766.6
Other Economic	<u>545.4</u>	<u>436.0</u>	<u>436.7</u>	<u>435.0</u>	<u>2,454.8</u>
Total US	820.6	712.1	731.1	833.0	5,221.4
UK	182.0	84.0	84.0	84.0	420.0
Other	<u>568.0</u>	<u>551.0</u>	<u>533.0</u>	<u>509.0</u>	<u>3,175.0</u>
TOTAL	1,570.6	1,347.1	1,348.1	1,426.0	8,816.4

- a. Calendar year. The Soviet Bloc has not yet committed itself to any new aid extensions during 1965. The USSR response to the recent Indian request for \$1 to 1.4 billion during 1966-71 is expected to be favorable.
- b. Fiscal year 1 July - 30 June. The Free World consortium has also agreed to extend India \$1,027 million during 1965-66.

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Table 2
 Economic Assistance Pledged to India
 By The Free World Consortium
 1961-65

(\$ Million)

<u>Consortium Members</u>	<u>1961/62</u>	<u>1962/63</u>	<u>1963/64</u>	<u>1964/65</u>	<u>1965/66</u>	<u>5-Year Total</u>
Austria	--	5	7	1	5	18
Belgium	--	10	10	--	4	24
Canada	28	33	30 $\frac{1}{2}$	41	41	173 $\frac{1}{2}$
France	15	45	20	20	20	120
Germany	225	139	99 $\frac{1}{2}$	95	86	644 $\frac{1}{2}$
Italy	--	53	45	36	36	170
Japan	50	55	65	60	60	290
Netherlands	--	11	11	11	11	44
United Kingdom	182	84	84	84	84	518
United States	545	435	435	435	435	2,285
World Bank and IDA	<u>250</u>	<u>200</u>	<u>245</u>	<u>245</u>	<u>245</u>	<u>1,185</u>
	1,295	1,070	1,052	1,028	1,027	5,472

Table 3

Military Assistance Pledged to India

				(\$ Million)
<u>Country</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>Cumulative Total (1954-64)</u>
Soviet Bloc				
USSR	<u>60.0</u>	<u>60.0</u>	<u>186.0</u>	<u>335.0</u>
Total	60.0	60.0	186.0	335.0
Free World				
US		129.0	110.0	303.7
UK	0	55.7	8.7	243.8
Other	<u>1.1</u>	<u>16.0</u>	<u>31.3</u>	<u>146.1</u>
Total	1.1	200.7	150.0	693.6

Table 4
 Economic Assistance Pledged to Pakistan

	(\$ Million)					
	1961	1962	1963	1964	1965	Cumulative Total (1948-65)
<u>Communist Countries a/</u>						
USSR	30.0	0	0	11.0	30.0	74.2
Communist China	0	0	0	60.0	0	60.0
Other	<u>0</u>	<u>0</u>	<u>0</u>	<u>28.0</u>	<u>0</u>	<u>28.0</u>
Total	30.0	0	0	99.0	30.0	162.2
<u>Free World b/</u>						
US	410.6	437.7	378.2	392.5		2,630.4
Of which PL 480	159.5	185.4	163.8	180.0		958.6
UK	23.8	23.8	22.4	22.4		93.2
Other	<u>198.7</u>	<u>198.7</u>	<u>207.8</u>	<u>196.1</u>		<u>1,190.0</u>
Total	633.1	660.2	608.4	611.0		3,913.6

a. Calendar year.

b. Fiscal year 1 July - 30 June.

Table 5

Economic Assistance Pledged to Pakistan
By the Free World Consortium, 1961-65

Consortium Members	(\$ Million)			
	1961-63	1963-64	1964-65	Four Year Total
Belgium	--	10.0	--	10.0
Canada	38.0	19.0	23.6	80.6
France	25.0	10	10.0	45.0
Germany	80.0	40	38.1	158.1
Italy	--	10.0	10.0	20.0
Japan	45.0	30.0	30.0	105.0
Netherlands	--	8.8	4.4	13.2
United Kingdom	47.6	22.4	22.4	92.4
United States	500.0	212.5	212.5	925.0
World Bank and IDA	<u>209.4</u>	<u>80.0</u>	<u>80.0</u>	<u>369.4</u>
Total	<u>945.0</u>	<u>442.7</u>	<u>431.0</u>	<u>1,818.7</u>

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Table 6

Military Assistance Pledged to Pakistan

	(\$ Million)			
	1962	1963	1964	Cumulative Total (1954-64)
<hr/>				
Soviet Bloc - None				
Free World				
US	50.5	62.2	56.5	732.3
UK	0	0	0	146.7
Other	<u>0</u>	<u>0</u>	<u>0</u>	<u>28.2</u>
Total	50.5	62.2	56.5	907.2
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